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TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PREL](#) [PGOV](#) [RS](#)  
SUBJECT: AMBASSADOR'S SEPTEMBER 27 MEETING WITH RUSSIAN  
FINANCE MINISTER KUDRIN

REF: MOSCOW 5629

Classified By: Amb. William J. Burns, Reasons 1.4 (b/d).

Summary

¶1. (C) In a September 27 meeting with the Ambassador, Russian Finance Minister Aleksey Kudrin gave few details on debt relief for Afghanistan, but noted he hoped to conclude a bilateral agreement by February 2007. On Iraq, Kudrin said resolving the Qurna-2 license issue was important but not a pre-condition for debt relief. He reiterated the GOR's commitment to continuing banking sector reforms that slain Central Bank (CBR) First Deputy Chairman Andrey Kozlov had championed. He said proposed 2007 budget spending increases would support GOR priorities during the last 18 months of Putin's term. Kudrin strongly emphasized his personal hope that a bilateral agreement on Russia's WTO accession will be concluded this fall. End Summary.

¶2. (U) In addition to Kudrin, Deputy Finance Minister Andrey Storchak and Tax Affairs Department Director Mikhail Motorin attended the September 27 meeting with Ambassador.

Afghan, Iraqi Debt

¶3. (C) Kudrin said that bilateral negotiations with Afghan authorities were underway and that he expected to conclude an agreement by February 2007. On Iraq, he noted that a bilateral agreement has already been negotiated; signing of the accord is all that remains. (Note: This differs from media accounts of Kudrin's statements on the margins of G7/G8 meetings in Singapore that "technical work was underway" on Iraqi debt forgiveness. End Note.) He said that Russia's position on debt relief was connected, "but not directly connected," to the restoration of Lukoil's license to operate the Qurna-2 oilfield.

¶4. (C) Kudrin recounted that Lukoil had hired a U.S. legal consultant to review the legitimacy of the firm's claim to Qurna-2 and lamented that the Iraqi government had not made a decision on the issue since it was raised 18 months ago. He commented that the GOR was obliged to fly the flag so that

Russian firms would know that the government was promoting their interests in Iraq. Both Kudrin and Deputy Minister Storchak maintained that the license issue had not delayed assistance to Iraq and would not lead to any negative financial consequences for Iraq.

15. (C) Kudrin added that there have been many positive developments in Russia's relationship with Iraq. He highlighted that the Iraqi government was prepared to sign an MOU on oil-related technical assistance and that Lukoil has pledged USD 4.5 million to redevelop neglected oilfields.

#### Expressions of Concern, Hope for WTO

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16. (C) Kudrin expressed concern that during the recent G7/G8 meetings in Singapore, Treasury Secretary Paulson had "hinted" a review of the financial services section of our bilateral WTO accession agreement might be forthcoming. Although he did not specify what issues Secretary Paulson mentioned, Kudrin told the Ambassador that a more appropriate time for discussion of Russia's financial sector market access commitments - further to what had already been agreed in our bilateral WTO accession negotiations - would be during Russia's negotiations on OECD accession. The Ambassador expressed hope that both countries' negotiators would be able to resolve pending issues in our bilateral WTO negotiations before Presidents Bush and Putin meet at the November APEC Summit.

#### Banking Sector Reforms

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17. (C) Regarding the murder of Central Bank (CBR) First Deputy Chairman Andrey Kozlov, Kudrin said that Kozlov was a man of conviction who, regrettably, irritated many "shadow economy groups." He noted that Gennady Melikyan's appointment as head of the CBR's Banking Supervision Committee was temporary and that officials were looking for "a stronger candidate" to succeed Kozlov. He stated matter-of-factly that banking reforms will continue and that "norms will be tougher."

18. (U) Kudrin explained that the Central Bank recently began the process of implementing Basel II capital adequacy standards to consolidate the banking sector, and speculated that banks unable to comply might be attractive acquisitions. He said that CBR controls in place following the mini-crisis of 2004 included close cooperation with the Interior Ministry, which has improved the pace of some investigations. Regulatory tools have helped bring some banks into compliance and have facilitated shutting down others. (Note: The CBR has revoked 110 licenses since 2004. End Note.)

#### 2007 Budget Overview

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19. (U) Kudrin defended the spending increases envisioned in the 2007 budget as nominal and in support of President Putin's goals. He maintained that the budget served the GOR's goals of reining in inflation, promoting economic growth, and adding to the Stabilization Fund, which will continue to grow as long as the per-barrel price of Ural oil is USD 27 or more. Kudrin clarified that the budget is balanced when oil is USD 37 per barrel. The GOR is also developing a proposed legislative amendment that will allow the government to submit a 3-year budget. He expected work on the first 3-year budget would begin by June of next year.

110. (U) Kudrin also described the GOR's tentative plans to institute a so-called Future Generations Fund that would begin accumulating revenue when the Stabilization fund reached 7 percent of GDP. (Note: The Stabilization Fund is currently around 6.5 percent of GDP. End Note.) He

pronounced the proposal as more political than economic or financial in nature, adding that Norway had developed such a fund, which now exceeds 100 percent of GDP, to pay for pension programs. Kudrin said that revenue from the natural resource sector would finance the Future Generations Fund, which would invest in as-yet unspecified instruments. The proceeds from these investments would eventually supplement the budget. He noted the GOR would elaborate on program details and goals again in November.

#### Specific Tax Issues

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¶11. (C) The Ambassador sought Kudrin's assistance in reviewing two tax issues that concern U.S. business interests. Tax authorities have assessed the Caspian Pipeline Consortium (CPC) USD 170 million in back taxes for purportedly wrongfully claiming certain 2002 interest payments as deductible expenses. The case has gone to trial and the September 15 decision was in favor of the tax authorities. Senior CPC managers are anxious that authorities could levy assessments of back taxes of reportedly up to USD 800 million. They are also troubled by the prospect of facing criminal charges. In another case, Pricewaterhouse Coopers (PwC) was alleged to have fraudulently deducted salary expenses for expatriate employees. Although the Finance Ministry has issued a letter explaining that PwC's deductions were consistent with standard Russian business practices, tax authorities are continuing with the case and have introduced what PwC considers immaterial evidence about its work with YUKOS, a former client.

¶12. (C) Tax Affairs Department Director Mikhail Motorin responded that regarding CPC there was nothing to suggest that criminal charges would be brought or would even be appropriate. However, he said that the tax rate in question

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was not onerous (Note: implying that the deductions for interest payments were unnecessary. End Note.) and maintained that tax inspectors had made a proper assessment. As for PwC, Motorin stated that the ministry's letter regarding PwC would be the determining factor. He expressed confidence that the case's outcome would correspond with the message contained in the ministry's letter.

#### Comment

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¶13. (C) Kudrin's attempt to play down the connection between Russia's bilateral agreement on Iraqi debt and Lukoil's claim to Qurna-2 was unconvincing, but he was eager to emphasize positive engagement with Iraq on the assistance and commercial fronts. We will continue to press the GOR on debt agreements with both Iraq and Afghanistan. We will also continue to urge the GOR to handle the CPC and PwC tax disputes in compliance with GOR law and prior understandings with both entities.

BURNS